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Panel: Image of Triple-A Rating Has Been Tarnished by Subprime Crisis

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By Peter Schroeder

Rating downgrades of bond insurers as a result of the subprime mortgage crisis have "effectively destroyed" the image of a triple-A rating, John Peterson, a professor of public policy at George Mason University, warned at a National League of Cities' conference.

Peterson also said the municipal market, "where the bond insurers made their fortune and got their fame, was an innocent bystander," and that he believes the nation is already in a recession due to the subprime mess and its resulting impacts.

Peterson delivered his comments Sunday at the NLC Congressional City Conference, as a member of a panel examining the housing crisis and its impact on the muni market.

He was joined on the panel by Brett Palmer, managing director of government relations for the National Association of Insurance Commissioners, Jill Hershey, senior vice president of legislative affairs for the Securities Industry and Financial Markets Association, and Susan Gaffney, director of the federal liaison center of the Government Finance Officers Association.

Gaffney told the group that the Securities and Exchange Commission should change its rules to make municipal bonds more available to money market funds. Currently, only muni bonds rated double-A or higher are available to those investment companies, but an argument has been made that there is a discrepancy between double-A corporate and municipal ratings, with the muni ratings proving more reliable on a historical basis. As a result, California Treasurer Bill Lockyer and other market participants have called for more uniform rating standards.

"The SEC should recognize that there are two different rating systems and if they recognize that, that means that a whole pool of munis ... could now be reached by another group of investors," she said.

Gaffney also addressed the controversial issue facing municipal issuers of auction-rate bonds: whether or not they can bid on their own offerings to avoid a failed auction. While some market participants have been concerned that such actions would run afoul of the securities laws, Gaffney suggested they could provide an important short-term fix for troubled issuers.

"We understand that the SEC is concerned that this might be considered market manipulation," she said. "What we're saying is that at this time it's a short-term help to allow us to bid on our own bonds."

An overarching theme among the panel members was that the struggles facing the muni market currently cannot be repaired immediately.

"This is not something that's going to be a quick fix," Palmer said.

But Peterson added: "It would be nice to say that we're only going through an episode that will pass, but that's not the case."